



## **ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM**

Combined Financial Statements  
June 30, 2001  
Together with Report of  
Independent Public Accountants

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June 30, 2001

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## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Director of the  
Arizona Health Care Cost Containment System:

We have audited the accompanying combined balance sheet of the ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM (AHCCCS, an agency of the State of Arizona), as of June 30, 2001, and the related statements of (1) revenues, expenditures and changes in fund balances - all governmental fund types; (2) revenues, expenditures and changes in fund balances of the General and Special Revenue Funds - (budget basis); (3) revenues, expenses and changes in retained earnings - proprietary fund; and (4) cash flows - proprietary fund, for the year then ended. These financial statements and the schedule referred to below are the responsibility of AHCCCS' management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AHCCCS as of June 30, 2001, and the results of its operations and the cash flows of its proprietary fund for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (Exhibit I) is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 29, 2001, on our consideration of AHCCCS' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

This report is intended solely for the information and use of AHCCCS and the State of Arizona Auditor General and is not intended to be and should not be used by anyone other than these specified parties.

*Arthur Andersen LLP*

Phoenix, Arizona  
November 29, 2001

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Combined Balance Sheet - All Fund Types and Account Groups

June 30, 2001

(Amounts in Thousands)

	Governmental Fund Types		Proprietary Fund	Account Groups		Totals (Memorandum Only)
	General Fund	Special Revenue Fund	Enterprise Fund	General Fixed Assets Account Group	General Long-Term Liability Account Group	
<u>Assets and Other Debits</u>						
Cash and Investments	\$ 94,552	\$ 112,614	\$ 7,923	\$ -	\$ -	\$ 215,089
Restricted Cash	-	1,658	-	-	-	1,658
Due from State and County Governments	31,612	7,960	-	-	-	39,572
Due from the Federal Government, net	119,142	-	-	-	-	119,142
Due from Other Funds	3,823	-	-	-	-	3,823
Receivables and Other	302	1,521	24	-	-	1,847
Furniture and Equipment	-	-	20	10,387	-	10,407
Amount to be Provided for Retirement of General Long-Term Liabilities	-	-	-	-	2,486	2,486
Total assets and other debits	<u>\$ 249,431</u>	<u>\$ 123,753</u>	<u>\$ 7,967</u>	<u>\$ 10,387</u>	<u>\$ 2,486</u>	<u>\$ 394,024</u>
<u>Liabilities and Fund Equity</u>						
Bank Overdraft	\$ 1,270	\$ -	\$ -	\$ -	\$ -	\$ 1,270
Accounts Payable	2,368	1,083	-	-	-	3,451
Other Accrued Liabilities	4,069	649	22	-	-	4,740
Deferred Revenue	-	1,033	3,391	-	-	4,424
Due to Federal, State and County Governments	7,837	498	-	-	-	8,335
Due to Other Funds	-	3,823	-	-	-	3,823
Accrued Programmatic Costs	161,431	5,995	1,239	-	-	168,665
Accrued Vacation Benefits	-	-	-	-	2,486	2,486
Total liabilities	<u>176,975</u>	<u>13,081</u>	<u>4,652</u>	<u>-</u>	<u>2,486</u>	<u>197,194</u>
Commitments and Contingencies						
Fund Equity:						
Net investment in fixed assets	-	-	-	10,387	-	10,387
Retained earnings	-	-	3,315	-	-	3,315
Fund balances	<u>72,456</u>	<u>110,672</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>183,128</u>
Total fund equity	<u>72,456</u>	<u>110,672</u>	<u>3,315</u>	<u>10,387</u>	<u>-</u>	<u>196,830</u>
Total liabilities and fund equity	<u>\$ 249,431</u>	<u>\$ 123,753</u>	<u>\$ 7,967</u>	<u>\$ 10,387</u>	<u>\$ 2,486</u>	<u>\$ 394,024</u>

The accompanying notes are an integral part of this combined balance sheet.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Revenues, Expenditures and Changes in Fund Balances -  
All Governmental Fund Types for the Year Ended June 30, 2001  
(Amounts in Thousands)

	General Fund	Special Revenue Fund
Revenues:		
State appropriations	\$ 507,780	\$ -
Federal government:		
Acute care	978,074	43,659
Long-term care	377,337	-
Pass through funds	412,976	-
County government:		
Acute care	65,486	-
Long-term care	144,294	-
Tobacco litigation settlement revenue	94,572	-
Tobacco tax revenue	-	84,585
Miscellaneous, primarily investment income	6,480	19,313
Total revenues	<u>2,586,999</u>	<u>147,557</u>
Programmatic Expenditures:		
Capitation:		
Acute care	952,552	102,574
Long-term care	735,389	-
Mental health services	134,406	7,426
Fee-for-service:		
Acute care	281,197	10,706
Long-term care	39,122	-
Disproportionate share	104,509	-
Graduate medical education	18,290	-
Reinsurance	62,922	10,637
Medicare premiums:		
Acute care	30,062	-
Long-term care	12,177	-
Health Education Centers	18,452	-
Children's Rehabilitative Services	21,097	-
Total programmatic expenditures	<u>2,410,175</u>	<u>131,343</u>
Administrative Expenditures	116,326	13,288
Administrative Expenditures Passed Through	19,730	-
Total expenditures	<u>2,546,231</u>	<u>144,631</u>
Excess of Revenues Over Expenditures before Transfers	40,768	2,926
Transfers Out:		
To General Fund	-	(31,933)
To Arizona Department of Health Services	-	(62,563)
To Health Crisis Fund	-	(960)
To Arizona Department of Economic Security	-	(17,903)
To Hawaii Arizona PMMIS Alliance	-	(2)
To Healthcare Group	-	(6,464)
Transfers In:		
From Special Revenue Fund	31,563	-
From Government Information Technology Agency	125	-
To State Children's Health Insurance	-	4
From State Treasurer	-	8,000
Excess of Revenues Over (Under) Expenditures after Transfers	<u>72,456</u>	<u>(108,895)</u>
Beginning Fund Balances	-	219,567
Ending Fund Balances	<u>\$ 72,456</u>	<u>\$ 110,672</u>

The accompanying notes are an integral part of this statement.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Revenues, Expenditures and Changes in Fund Balances  
of the General and Special Revenue Funds - (Budget Basis) for the Year Ended June 30, 2001  
(Amounts in Thousands)

	General Fund		Special Revenue Funds	
	Appropriation (Budget)	Actual	Appropriation (Budget)	Actual
				Under/(Over) Spending Authority
Revenues:				
State appropriations	\$ 514,582	\$ -		
Federal government	1,359,601	42,275		
Federal pass-through funds	392,476	-		
County government	210,258	-		
Tobacco Litigation Settlement	59,925	2,178		
Miscellaneous	6,437	44,453		
Total revenues	2,543,279			
Other Financing Sources:				
Operating transfer in	81,654	21,838		
Total revenues and other financing sources	2,624,933	66,291		
Programmatic Expenditures:				
Acute capitation	\$ 960,710	960,451	\$ -	\$ -
Acute fee-for-service	276,386	276,314	-	-
SCHIP Services	-	-	71,163	61,880
Reinsurance	53,096	53,096	-	-
Medicare premiums	30,166	30,062	-	-
Graduate medical education	18,290	18,290	-	-
Disproportionate share	121,674	121,674	-	-
Long-term care	571,097	556,324	-	-
Total programmatic expenditures	2,031,419	2,015,211	71,163	61,880
Administrative Expenditures	121,396	114,529	8,533	6,389
Total appropriated expenditures	\$ 2,152,815	2,129,740	\$ 79,696	68,269
Non-Appropriated Expenditures		438,310		111,049
Revenues and Other Financing Sources Over (Under) Expenditures		56,883		(113,027)
Beginning Fund Balances		13,859		223,768
Ending Fund Balances		\$ 70,742		\$ 110,741

The accompanying notes are an integral part of this statement.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Revenues, Expenses and Changes in Retained Earnings - Proprietary Fund  
For the Year Ended June 30, 2001  
(Amounts in Thousands)

	Enterprise Fund
Revenues:	
Premiums	\$ 21,024
Investment income	<u>491</u>
Total revenues	<u>21,515</u>
Operating Expenses:	
Premiums paid to health plans	20,328
Reinsurance premiums	<u>4,481</u>
Total operating expenses	<u>24,809</u>
General and Administrative Expenses:	
Salaries and employee benefits	546
Professional and outside services	124
Other expenses	162
Depreciation expense	<u>9</u>
Total general and administrative expenses	<u>841</u>
Total expenses	<u>25,650</u>
Net Loss Before Transfers from Other Funds	(4,135)
Transfers In (Out):	
Transfer In - Special Revenue Fund	6,464
Transfer (Out) – General Fund - Tobacco Litigation Settlement	<u>(1,983)</u>
Net Income	346
Retained Earnings, beginning of year	<u>2,969</u>
Retained Earnings, end of year	<u>\$ 3,315</u>

The accompanying notes are an integral part of this statement.

## ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Cash Flows - Proprietary Fund  
For the Year Ended June 30, 2001  
(Amounts in Thousands)

	<u>Enterprise Fund</u>
Cash Flows from Operating Activities:	
Net income	\$ 346
Adjustment to reconcile net income to cash provided by operating activities-	
Depreciation expense	9
Changes in net assets and liabilities:	
Decrease in receivables and other	2,392
Increase in deferred revenue	686
Decrease in other accrued liabilities	<u>(1,155)</u>
Net cash provided by operating activities	2,278
Cash and Investments, beginning of year	<u>5,645</u>
Cash and Investments, end of year	<u><u>\$ 7,923</u></u>

The accompanying notes are an integral part of this statement.

## ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Notes to Combined Financial Statements  
June 30, 2001  
(Dollar Amounts in Thousands)

### 1. Arizona Health Care Cost Containment System Operations

The Arizona Health Care Cost Containment System (AHCCCS), an agency of the State of Arizona (State), was established by the Arizona Legislature in November 1981 to administer healthcare for the State's indigent population. AHCCCS is a State agency managed by an independent cabinet level administration created by the Arizona Legislature, and it is funded by a combination of Federal, State and County funds. The Federal portion is funded through the Centers for Medicare and Medicaid Services (CMS), formerly known as the Health Care Financing Administration (HCFA), of the U.S. Department of Health and Human Services under a Section 1115 waiver approved by CMS, which exempts the AHCCCS program from certain requirements of conventional Medicaid programs. This waiver has been renewed by CMS through September 30, 2002. AHCCCS receives quarterly Federal grants from CMS (as matching funds) to cover a portion of the healthcare costs of the residents of the State eligible for the State's Title XIX (Medicaid) and Title XXI State Children's Health Insurance Program (SCHIP). State appropriations and county funds are based on a yearly budget as dictated by the Arizona Legislature and specified in Arizona Session Law.

AHCCCS provides acute and long-term healthcare coverage to eligible residents of Arizona. Eligible residents include those who qualify under Section 1931(b) of the Social Security Act, Supplemental Security Income (SSI), children who meet certain age requirements from families receiving food stamps, and children and pregnant women whose household income meets eligibility requirements. Other low income persons may qualify by meeting certain income and resource criteria as certified by the county eligibility offices.

Under AHCCCS, healthcare coverage is provided substantially through a competitive bidding process with private and county-sponsored health plans bidding for the enrollment of AHCCCS eligibles by geographic service area. AHCCCS awards contracts to the plans for the acute and long-term care populations. In addition, AHCCCS purchases healthcare services directly from providers.

Other AHCCCS lines of business include the Healthcare Group, which provides prepaid medical coverage primarily to small businesses, and the Premium Sharing Program, which provides coverage to individuals who meet certain income criteria and who are not covered through other health insurance programs. See Notes 5 and 6 for more information on these programs.

### 2. Summary of Significant Accounting Policies

The accounting policies of AHCCCS conform to accounting principles generally accepted in the United States applicable to governmental units. The following is a summary of the significant accounting policies.

#### a. Basis of Presentation

The accounting system is organized and operated on a fund basis. The Account Groups and Special Revenue and Enterprise Funds are described in Notes 3, 4, 5, and 6.

The financial statements present the Governmental Funds on the modified accrual basis of accounting. The Enterprise Fund is presented on the accrual basis of accounting. See Note 6 for a description of the Enterprise Fund.

b. Revenues and Expenditures - Governmental Funds

Revenues and other financial resources are recognized in the accounting period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year end. Expenditures and other uses of financial resources are recognized when the related fund liability is incurred. Accrued programmatic costs include estimates for incurred but not reported claims (IBNR). Actual results for accrued programmatic costs may differ from such estimates. These differences are recorded in the period that they are identified.

c. Revenues and Expenses - Enterprise Fund

Revenues are recognized when they are earned and expenses are recognized when they are incurred. Premiums are due by the first day of the month preceding the month of coverage. At June 30, 2001, the deferred revenue balance was comprised of premium payments received for the months of July and August 2001.

d. Encumbrances

Purchase orders, contracts and other commitments for expenditures are encumbered in order to reserve that portion of the applicable appropriation. This practice is employed as an extension of formal budgetary control. Total encumbrances outstanding at June 30, 2001 were \$107,067.

e. Cash and Investments

Substantially all of the cash and investments maintained by AHCCCS is held in the State of Arizona Office of the Treasurer (the Treasurer). The cash and investments are invested by the Treasurer, are recorded at fair value, and investment income is allocated to AHCCCS on a pro rata basis. Amounts held by the Treasurer totaled \$215,459 at June 30, 2001.

The State is statutorily limited (by ARS 35-312 & 35-313) to certain investment types. Additionally, state statutes require the State to make investments in accordance with the "Prudent Person" rule. This rule imposes the responsibility of making investments with the judgment and care that persons of ordinary prudence would exercise in the management of their own affairs when considering both the probable safety of their capital and the probable income from that capital. The Treasurer issues a separately published Annual Financial Report that provides additional information relative to the Treasurer's total investing activities.

A portion of the special revenue fund cash is restricted in the amount of \$1,658 for the Hawaii Arizona PMMIS (HAPA) project as described in Note 5.

In accordance with the Federal Cash Management Improvement Act guidelines, AHCCCS may only request Federal funds under specified funding techniques. These techniques require that AHCCCS draw down or request funds for any checks issued, in accordance with its historical average check clearing pattern. The timing difference that is created, due to drawing down funds over an extended time period to cover an issued check, results in bank overdrafts to AHCCCS at various times in the year. At June 30, 2001, a bank overdraft of \$1,270 existed which represents the excess of checks issued over funds drawn.

f. Capitation Payments

AHCCCS' contracted health plans receive fixed capitation payments, generally in advance, based on certain rates for each AHCCCS member enrolled with the plan. The plans are required to provide all covered healthcare services to their members, regardless of the cost of care. If there are funds remaining, the plan retains the funds as profit; if the costs are higher than the amount of revenue received, the plan absorbs the loss, except for those cases eligible for reinsurance payments.

AHCCCS capitates its contracted health plans for the cost of providing medical services to eligible persons from the date of eligibility to the time of enrollment with a contracted health plan. This period is referred to as prior period coverage (PPC) and was historically covered by AHCCCS on a fee-for-service basis. AHCCCS reimburses the health plans for the amount actual PPC medical expenses exceed capitation and reinsurance paid. Accrued programmatic costs include approximately \$1,643 at June 30, 2001, that represents estimated settlements payable to contracted health plans for PPC. Actual results may differ from this estimate and such differences will be recorded in the period in which they are identified.

g. Reinsurance Payments

AHCCCS provides a stop-loss reinsurance program for its contracted health plans for partial reimbursement of covered inpatient facility medical services incurred for members with an acute medical condition. For long-term care members, the program includes a deductible, which varies based on the health plan's member enrollment and the eligibility category of their members. For acute care members, health plans choose their deductible level for all eligibility groups. AHCCCS reimburses the health plans based on a coinsurance amount for inpatient covered services incurred above the deductible.

The reinsurance program provides coverage for the PPC time period. PPC cases are reimbursed at 100% after the deductible of \$5 is met. This deductible level applies to all health plans. See Note 2f for more information on PPC.

The reinsurance program also includes a special catastrophic reinsurance program, which covers conditions such as hemophilia or those conditions resulting in a covered organ transplantation. There is no deductible for catastrophic reinsurance cases, and AHCCCS reimburses the health plans at a percentage of the health plan's adjusted billed charges up to \$650 at which point all adjusted billed charges are covered.

h. Fee-for-Service Payments

The AHCCCS program is responsible for the cost of providing medical services on a fee-for-service basis to four populations: persons enrolled in the Emergency Services Program (ESP), prior quarter coverage for members enrolled in a health plan, persons enrolled in a health plan for less than 30 days, and Native American members enrolled with Indian Health Services (IHS). The ESP provides for emergency medical care to persons who are ineligible for full AHCCCS coverage due to their lack of U.S. citizenship or lawful alienage status. Prior quarter coverage relates to the 90-day period prior to the first day of application of a member. AHCCCS covers any unpaid bills during this period for members who would have been eligible for coverage for some period of time in that 90-day period. Effective October 1, 2001, prior quarter coverage was eliminated.

Outpatient medical services for the ESP, prior quarter coverage and for members enrolled in a health plan for less than 30 days are reimbursed at capped fee-for-service rates based on the category of service provided. Inpatient medical services for these populations are reimbursed based upon an inpatient per diem reimbursement rate system.

Medical services provided at an IHS facility or by a tribal-owned facility licensed by IHS are reimbursed at rates determined by the Office of Management and Budget (OMB). Off-reservation services are reimbursed based on the AHCCCS inpatient and outpatient fee-for-service rates.

i. Disproportionate Share Hospital Payments

During 2001, CMS and the Arizona Legislature authorized AHCCCS to pay disproportionate share to Arizona hospitals that had provided care to a disproportionate share (as defined) of the State's indigent population. Also included in this total are amounts paid to certain qualifying counties having a population

of 500,000 persons or less. Expenditures for disproportionate share totaled \$104,509 for the year ended June 30, 2001. At June 30, 2001, accrued programmatic costs include \$17,165 of disproportionate share payable.

j. Taxes

AHCCCS is an agency of the State of Arizona and is not subject to income taxes.

k. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at June 30, 2001, and the reported amounts of revenues and expenditures during the fiscal year then ended. Actual results may differ from those estimates.

l. 100% Federal Poverty Level Expansion and CMS Waiver

During 2001 the Arizona voters approved ballot proposition number 204. One of its primary components directed AHCCCS to increase the qualifying income eligibility level up to 100% of the Federal Poverty Level. The proposition also designated AHCCCS as the administrators of the tobacco litigation settlement funds awarded to the State for compensation of costs incurred in providing its citizens with healthcare and other services necessitated by the use of tobacco products.

AHCCCS obtained a waiver from the CMS to receive Federal funding for the newly eligible populations and to fund additional legislation passed during the 2001 State legislative session to implement the proposition. The CMS waiver requires that the newly covered population not previously categorically eligible for Medicaid be budget neutral for CMS. The waiver period for budget neutrality began April 1, 2001 and extends through Federal fiscal year 2006 at which time any Federal funds received by the State that exceed the negotiated budget neutrality limit must be returned to CMS. Because any future settlement amount is currently not measurable, a liability for any excess Federal funds has not been recorded.

AHCCCS has classified the Arizona Tobacco Litigation Settlement Fund, created by the ballot proposition, as part of its General Fund. These funds are restricted for use as specified in litigation settlement and/or legislation. Annual settlement payments are made in April. In addition to annual payments, the agreement requires that five one-time payments be made in January of each year. As of June 30, 2001, two one-time payments remain outstanding. The payments are subject to several adjustments for such factors as cigarette production and annual sales volume that are not presently determinable. Therefore, an accrual was not made for those payments at June 30, 2001.

3. General Fixed Assets

Furniture and equipment purchases for Governmental Fund types are recorded as expenditures in the General Fund and Special Revenue Fund and are capitalized at acquisition cost in the General Fixed Assets Account Group. Depreciation has not been provided on general fixed assets.

Balance, June 30, 2000	\$ 8,248
Additions	2,617
Retirements	<u>(478)</u>
Balance, June 30, 2001	<u>\$ 10,387</u>

4. General Long-Term Liability

Long-term liabilities for the Governmental Fund types are recorded in the General Long-Term Liability Account Group. The General Long-Term Liability Account Group consists of employees' vested accrued vacation and accrued compensatory time benefits, other than sick leave which is accrued and payable by the State.

Balance, June 30, 2000	\$ 2,094
Net increase in accrued vacation and accrued compensatory time benefits	<u>392</u>
Balance, June 30, 2001	<u>\$ 2,486</u>

5. Special Revenue Fund

The Arizona Department of Revenue has allocated funding to AHCCCS' Special Revenue Fund. At June 30, 2001, the Special Revenue Fund balance of \$110,672 was available for the following programs:

- Medically Needy Account to provide services to the AHCCCS Title XIX population or to persons who cannot afford services or who would otherwise not be covered by other AHCCCS programs except through medical expense deductions. This program is funded from Tobacco tax proceeds and investment income.
- Medical Services Stabilization Fund to offset increases in the cost of providing services to certain eligible members. This fund was originally funded by the Medically Needy Account. Any remaining funds will be transferred back to the Medically Needy Account at June 30, 2003.
- Premium Sharing Program Fund is a medical services coverage program for the uninsured funded from Tobacco Tax proceeds and premiums collected from participants.
- Third Party Liability Fund is comprised of monies recovered from first and third party payors under various AHCCCS recovery programs. These programs include casualty, special treatment trusts, estate and health insurance recoveries.
- KidsCare Fund, Arizona's Title XXI State Children's Health Insurance Program, provides comprehensive healthcare coverage to targeted low-income children up to the age of 19. The program is funded from Tobacco Tax proceeds and from Federal funds.
- Miscellaneous Funds that account for miscellaneous private grants and other monies received for specific purposes, including HAPA, which is AHCCCS' project with Hawaii whereby AHCCCS processes the claims for Hawaii's Medicaid program. Transfers from the Special Revenue Fund of \$370 were used to offset costs incurred and expensed in the General Fund by AHCCCS in connection with HAPA.

Special Revenue funds earned, expended and transferred during the fiscal year ended June 30, 2001, were as follows:

	Medically Needy Account	Medical Services Stabilization Fund	Premium Sharing Program Fund	Third Party Liability Fund	KidsCare Fund	Miscellaneous Funds	Total
Fund Balances, June 30, 2000	\$ 86,557	\$ 73,845	\$ 45,983	\$ 3,091	\$ 8,997	\$ 1,094	\$ 219,567
Receipts	84,585	-	-	-	43,317	342	128,244
Interest Earned	2,942	4,809	4,514	274	2,005	4,769	19,313
Expenditures	(30,994)	(22,005)	(23,460)	(632)	(60,016)	(7,524)	(144,631)
Transfers:							
Arizona Department of							
Health Services	(47,680)	(14,883)	-	-	-	-	(62,563)
General Fund	(31,563)	-	-	-	-	(370)	(31,933)
Health Crisis Fund	(960)	-	-	-	-	-	(960)
Arizona Department of							
Economic Security	(500)	(17,403)	-	-	-	-	(17,903)
State Children's Health							
Insurance Program	(13,234)	-	-	-	13,238	-	4
Hawaii Arizona PMMIS							
Alliance	-	-	-	-	-	(2)	(2)
State Treasurer	-	-	-	-	-	8,000	8,000
Healthcare Group	-	(969)	-	-	-	(5,495)	(6,464)
Fund balances, June 30, 2001	<u>\$ 49,153</u>	<u>\$ 23,394</u>	<u>\$ 27,037</u>	<u>\$ 2,733</u>	<u>\$ 7,541</u>	<u>\$ 814</u>	<u>\$ 110,672</u>

#### 6. Enterprise Fund

The Healthcare Group was established in 1988 by the State of Arizona to administer prepaid medical coverage primarily to small uninsured businesses with 2-50 employees and employees of political subdivisions. Healthcare Group Administration (HCGA) contracts with the existing network of the AHCCCS-funded health plans to enroll members and provide healthcare services. HCGA conducts premium billing, collections and fund disbursement, data analysis and is responsible for the regulatory oversight of the health plans.

For State fiscal year 2001, the Arizona Legislature authorized an appropriation of \$8 million from the Tobacco Settlement Fund for Healthcare Group, to be allocated among Healthcare Group health plans based on the budget projections of the plans, with reconciliation of the funds at year-end. Current legislation only provides the appropriated funding for Healthcare Group through State fiscal year 2002. The Arizona Legislature also authorized that any monies that remained unexpended by December 31, 2000, for the previous state fiscal year, were to be used to offset the appropriation for the next fiscal year. Monies remaining as of December 31, 2000, were \$1,983. These remaining monies were transferred from the Healthcare Group to the Arizona Tobacco Litigation Settlement Fund during 2001, and are classified as Tobacco Litigation Settlement Revenue in the general fund.

#### 7. Retirement Plan

AHCCCS employees, as defined, are covered by a defined benefit retirement plan administered by the Arizona State Retirement System Board. Benefits are established by state statute and provide retirement and long-term disability benefits to AHCCCS employees. The retirement plan is funded by payroll deductions from eligible employees' gross wages and matching amounts contributed by AHCCCS. These amounts satisfy the statutory requirement that employee and AHCCCS contributions must cover the actuarially determined current service costs of the retirement plan, plus amortization over a 30-year period of the unfunded past service liability. Payroll deductions as a percentage of employee wages were 2.17% for retirement and .0049% for long-term disability for

2001. The matching amount contributed to the retirement plan by AHCCCS was \$823 in 2001 and is included in administrative expenditures in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types.

Retirement benefit payments are obligations of the retirement plan and not AHCCCS. Actuarial and financial data on the retirement plan are available from the retirement plan's separately issued Comprehensive Annual Financial Report.

#### 8. Budgetary Basis of Accounting

The agency financial statements of AHCCCS are prepared in conformity with accounting principles generally accepted in the United States (GAAP basis). AHCCCS, like all other State of Arizona agencies, prepares its annual budget on a basis which differs from the GAAP basis. The State's accounting system and policy provides for an additional accounting period (13th month) to make payments for goods or services received by the end of the fiscal year and subsequently invoiced during the 13th month. The statement reports total budget basis expenditures to include both the fiscal year and the 13th month activity. The State does not have a legally adopted budget for revenues. The reported appropriated (budget) amount is the final fiscal year appropriation after any adjustments plus any prior fiscal year expenditures paid in the current fiscal year in accordance with the administrative adjustment procedure as authorized by Arizona Revised Statutes. AHCCCS' controlling statute for program administrative adjustment procedures varies from the statutory requirement of other State agencies. AHCCCS is permitted to pay for approved system covered services presented after the close of the fiscal year in which they were incurred with either remaining prior year or current fiscal year available monies. This provides the opportunity for program expenditures to equal the appropriation (budget) amount. The following is a reconciliation of the GAAP basis financial statements to the budget basis for the year ended June 30, 2001:

	General Fund Actual	Special Revenue Fund Actual
Budgetary Basis Fund Balance, June 30, 2001	\$ 70,742	\$ 110,741
Basis of Accounting Differences:		
Increases to Fund Balance:		
Due from State and County governments	24,756	5,931
Due from the Federal government	118,956	-
Due from other funds	1,229	(125)
Receivables and other	302	37
Total increases	145,243	5,843
Decreases to Fund Balance:		
Deferred revenue	(1,588)	(1,033)
Due to State and County governments	(5,452)	(109)
Due to the Federal government	(1,228)	(498)
Due to other funds	-	(3,440)
Accrued programmatic costs	(133,076)	(500)
Payables and other	(2,185)	(332)
Total decreases	(143,529)	(5,912)
Total GAAP Basis Fund Balance, June 30, 2001	\$ 72,456	\$ 110,672

Non-appropriated expenditures of \$438,310 and \$111,049 in the general and special revenue funds, respectively, consist of Federal pass-through payments to other agencies, 100% Federal poverty level expansion payments, and CMS waiver payments.

9. Contingencies

a. Grant Adjustments

Amounts received from CMS are subject to audit and adjustment. At June 30, 2000, AHCCCS had claimed reimbursement from CMS on its Form HCFA-64 of approximately \$37 million representing additional reimbursement AHCCCS believes it is due for healthcare services provided to Native Americans off the reservation. CMS disallowed this claim during 2001. AHCCCS appealed this decision and the Department of Health and Human Services' Departmental Appeals Board upheld the disallowance. As a result, AHCCCS has not drawn down these funds from CMS nor are they included in the accompanying financial statements. AHCCCS believes reimbursement of these funds is supported in law and is considering pursuing recovery of these funds. There were no other pending disallowances of Federal funds drawn as of June 30, 2001.

b. Litigation and Investigations

AHCCCS has been named as a defendant in a variety of litigation, all of which are being defended by legal counsel. It is the opinion of AHCCCS, upon consultation with legal counsel, that none of these claims is likely to have a material adverse effect on AHCCCS' financial statements. In addition, AHCCCS believes that the funding of any material adverse judgment, sanction or repayment obligation in excess of its appropriation would require a special appropriation by the State.

c. Compliance with Laws and Regulations

AHCCCS is subject to numerous laws, regulations and oversight by the Federal government. These laws and regulations include, but are not necessarily limited to, matters such as, government healthcare program participation requirements, reimbursement for member services and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs, together with the imposition of significant financial sanctions. Management believes that AHCCCS is in compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

10. Transactions with Other State Agencies

AHCCCS contracts for administrative and programmatic services from other state agencies. Charges for administrative services are based on the performing agencies' actual cost. Charges for programmatic services are generally based on actuarially determined capitation rates. The following is a summary of contracted services provided.

a. Administrative Services

The State of Arizona's Department of Economic Security (DES) charges AHCCCS to determine eligibility for certain Title XIX members. The State's Department of Administration charges AHCCCS for data center services and equipment costs. The State's Department of Health Services (DHS) charges AHCCCS for licensure and preadmission screening and resident review services. These expenditures are included in administrative expenditures in the accompanying statement of revenues, expenditures and changes in fund balances - all governmental fund types. The following is a summary of transactions with these State agencies for the services described above for the year ended June 30, 2001.

	<u>Expenditures</u>
Department of Economic Security	\$ 44,293
Department of Administration	6,268
Department of Health Services	<u>1,007</u>
	<u>\$ 51,568</u>

b. Programmatic Services

Certain healthcare-related programmatic services are provided by other State agencies, which include DES and DHS. AHCCCS receives the Federal funds for these services and transfers them to the appropriate agencies pursuant to the terms of intergovernmental agreements. The total amount of Federal funds received by AHCCCS and passed through to these agencies was \$396,157 in 2001. The amount passed through to DES totaled \$242,570 in 2001 and is classified as long-term care capitation programmatic expenditures in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types. The DHS pass-through expenditures totaling \$153,587 are classified as capitation-mental health services and Children's Rehabilitative Services. The amount due to other state agencies for programmatic services was \$1,287 as of June 30, 2001, and is included in the due to federal, state and county governments in the accompanying combined balance sheet.

Revenues include \$209,780 from Arizona counties during fiscal 2001. To the extent expenditures for long-term care services are less than County and State revenues, AHCCCS is required to remit such amounts equally to the State of Arizona and the Counties. At June 30, 2001, AHCCCS has accrued \$3.4 million, payable 50% to the State and 50% to the counties, relating to the amount County and State revenues will exceed related expenditures. This amount is included in the due to Federal, State and County governments in the accompanying combined balance sheet.

11. Other Pass Through Funds

Arizona school districts are eligible for Federal matching funds for the administrative functions related to Early and Periodic Screening, Diagnosis and Treatment outreach services at the school level. The total amount of Federal funds received by AHCCCS and passed through to Arizona school districts was \$16,290 in 2001. Arizona school districts are also eligible for Federal matching funds on a fee-for-service basis for the provision of certain AHCCCS program services provided to eligible students. The total amount of fee-for-service expenditures made to Arizona school districts was \$26 in 2001.

The counties are eligible for Federal matching funds for administrative functions relating to certain eligibility determinations. The counties contract with AHCCCS to obtain these Federal funds. The total amount passed through to the counties in 2001 was \$3,042. Approximately \$36 was passed through to DHS in connection with an agreement between DHS and the Federal Department of Health and Human Services. The amount of \$19,730 is classified as administrative expenditures passed through and the amount of \$412,976 is classified as revenue pass through funds on the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types.

## 12. New Pronouncements

AHCCCS adopted the following pronouncements during 2001:

- GASB Statement No. 33 - Accounting and Financial Reporting for Nonexchange Transactions: This statement establishes accounting and financial reporting standards for financial or capital nonexchange transactions, e.g. receipt of Federal grant funding. This statement was effective for AHCCCS during fiscal year 2001, and did not have a material impact on AHCCCS' financial statements.
- GASB Statement No. 36 - Recipient Reporting for Certain Shared Nonexchange Revenues - an Amendment of GASB 33: This statement amends GASB Statement No. 33 to eliminate the timing difference by requiring recipient governments to account for the sharing of revenues in the same manner as the providing government. This statement was effective for AHCCCS during fiscal year 2001, and did not have a material impact on AHCCCS' financial statements.

There are two new Government Accounting Standards Board (GASB) pronouncements that may affect AHCCCS' financial reporting in future periods:

- GASB Statement No. 34 - Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: This statement modifies the requirements for the basic financial statements of governments and governmental agencies to include Management's Discussion and Analysis, which introduces the basic financial statements and provides an analytical overview of the financial activities. Required supplementary information will also be required to include budgetary comparison schedules. This statement is effective for AHCCCS for its fiscal year beginning July 1, 2001.
- GASB Statement No. 38 - Certain Financial Statement Note Disclosures: This statement modifies, establishes and rescinds certain financial statement disclosure requirements for general purpose external financial reporting by state and local governments. This statement is effective simultaneous with Statement No. 34.

Management believes that the impact of implementing these new standards will not be material to the financial position or operations of AHCCCS.

## 13. Subsequent Events

The State's General Fund revenue collections have been short of budget expectations beginning in late fiscal year 2001 and that trend has continued into fiscal year 2002. This economic downturn has been intensified by the effects of the September 11, 2001 national tragedy resulting in a significant decline in the State's revenue stream. AHCCCS' Management is currently unable to estimate the budgetary impact on its operations for fiscal year 2002 and beyond. However, AHCCCS has prepared plans to reduce both the administrative and program budgets to the extent possible, and fully expects some level of budget cuts for fiscal year 2002 and beyond to be dictated by the Arizona Legislature as specified in Arizona Session Law.

**EXHIBIT I**

**ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM**

Schedule of Expenditures of Federal Awards  
For the Year Ended June 30, 2001  
(Amounts in Thousands)

	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
<b>U.S. Department of Health and Human Services</b>		
Health Care Financing Administration		
Medicaid Program (Title XIX)	93.779	
Federal funds expended to vendors		\$ 1,355,411
Federal funds expended to subrecipients		<u>412,976</u>
		1,768,387
 State Children's Health Insurance Program (Title XXI)	 93.767	 43,317
 Maternal and Child Health Bureau		
Healthy Start South Phoenix Project	93.926B	<u>342</u>
Total expenditures of Federal awards		<u>\$ 1,812,046</u>

**REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT  
AUDITING STANDARDS**

To the Director of the  
Arizona Health Care Cost Containment System:

We have audited the financial statements of the ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM (AHCCCS, an agency of the State of Arizona), as of and for the year ended June 30, 2001 and have issued our report thereon dated November 29, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Compliance***

As part of obtaining reasonable assurance about whether AHCCCS' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

***Internal Control Over Financial Reporting***

In planning and performing our audit, we considered AHCCCS' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A *material weakness* is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted certain other matters that we have communicated to management of AHCCCS in a separate letter dated November 29, 2001.

This report is intended solely for the information and use of the management of AHCCCS and the State of Arizona Auditor General and is not intended to be and should not be used by anyone other than these specified parties.



Phoenix, Arizona  
November 29, 2001